LIBRARY
SUPREME COURT, U. S.

Office-Supreme Court, U.S.
FILED
MAY 15 1962
JOHN F. DAVIS, CLERK

No. 62

IN THE

Supreme Court of the United States

OCTOBER TERM, 1962

NORTHERN NATURAL GAS COMPANY, a Corporation,
Appellant,

v.

THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS, *Appellee.*

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF KANSAS

REPLY TO MEMORANDUM FOR THE FEDERAL POWER COMMISSION

JEROME ACKERMAN
Union Trust Building
Washington 5, D. C.

CHARLES C. McCARTER
State Corporation Commission
State Office Building
Topeka, Kansas

Attorneys for Appellee

May 15, 1962

INDEX

CITATIONS.

Cases: Page

Amy v. *Watertown*, 130 U.S. 301 6
Cities Service Co. v. *State Commission of Kansas*, 355 U.S. 391 9
Colorado Interstate Gas Co. v. *State Corporation Commission*, Case No. 42185, Supreme Court of Kansas 6
Hudson County Water Co. v. *McCarter*, 209 U.S. 349 3
Leiter Minerals, Inc. v. *United States*, 352 U.S. 220 5
Northern Natural Gas Company v. *Republic Natural Gas Company*, 172 Kan. 450, 241 P. 2d 708 4
Northern Natural Gas Co., et al. v. *State Corporation Commission*, Cases Nos. 42175, 42176, 42230, Supreme Court of Kansas 6
Panhandle Eastern Pipeline Co. v. *Michigan Public Service Commission*, 341 U.S. 329 9
Panhandle Eastern Pipeline Co. v. *Public Service Commission of Indiana*, 332 U.S. 507 9
Permian Basin Pipeline Co. v. *Railroad Commission of Texas*, 358 U.S. 37 ..... 10, 11
Phillips Petroleum Co. v. *Wisconsin*, 347 U.S. 672 8
St. Louis Poster Adv. Co. v. *St. Louis*, 249 U.S. 269 3
Soon Hing v. *Crowley*, 113 U.S. 703 6
Southwestern Kansas Royalty Owners Association v. *State Corporation Commission, et al.*, Case No. 42038, Supreme Court of Kansas 6
Stephenson v. *Binford*, 287 U.S. 251 6
Williamson v. *Lee Optical Co.*, 348 U.S. 483 7

Statute:

Natural Gas Act (15 U.S.C. § 717 *et seq.*) ..... 2, *et seq.*

IN THE

Supreme Court of the United States

OCTOBER TERM, 1961

No. 659

NORTHERN NATURAL GAS COMPANY, a Corporation,
Appellant,

v.

THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS, *Appellee.*

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF KANSAS

REPLY TO MEMORANDUM FOR THE FEDERAL POWER COMMISSION

The Memorandum for the Federal Power Commission fails to show that this case raises any substantial Federal question. The principal argument advanced in the memorandum raises what is essentially a question of Kansas law, relies in large measure upon matters that are *dehors* the record, and rests upon a misunderstanding of the nature of the regulatory order of the Kansas Commission that is here involved.

1. The principal argument made in the memorandum is that the order of the Kansas Commission "exerts leverage upon interstate pipelines to purchase natural gas from one State rather than another" and therefore "enters into the field occupied by the Natural Gas Act and is invalid under the Supremacy Clause." (Memorandum, p. 2)

The fact is that the provisions of the Kansas regulation do not exert any kind of leverage upon interstate pipelines to purchase gas in one state rather than in another. The regulation does not require appellant or any pipeline company to take any particular volume of gas, or indeed any gas whatsoever, from any particular seller, or from any field, or from any state. The regulation simply directs appellant and all other takers in the Kansas-Hugoton field to take gas ratably from every well in the field to which each taker is connected. Appellant could fully comply with the terms of the order without increasing its purchases in Kansas, or decreasing its purchases in other states, and without affecting the total volume of gas it moves in interstate commerce.[1]

The Commission's only answer to this indisputable fact is that appellant has entered into private contractual arrangements with a favored supplier in the Kansas-Hugoton field which require it to take a large volume of gas from that supplier, and that since it is thus contractually bound, it will as a result of the regulation "presumably" be forced to increase its purchases

[1] The pertinent part of the ratable take order reads: " • • • each purchaser shall take gas in proportion to the allowables from all the wells to which it is connected and shall maintain all such wells in substantially the same proportionate status as to overproduction or underproduction • • •." (R. 98, No. 42,127)

from other suppliers in the field. Thus the memorandum asserts (pp. 8-9):

> "The ratable-take order involved in the present case, in effect, established a floor for each purchaser by requiring him to take from all his connected wells at the highest rate at which he was obligated to take from any of them. Under the order, Northern will be required to take the same percentage of the allowable for each connected well that it is required to take from the 'Republic "A"' wells under its contracts with that supplier. Northern will therefore presumably have to increase substantially its rate of take from its other suppliers in Kansas and reduce its take from its suppliers in other states."

Even were the Commission correct as to the effect of appellant's gas purchase contract with its favored supplier, the argument that otherwise valid state regulation cannot be applied to particular persons because of their private contracts with third parties is without merit. A person cannot avoid the order of a regulatory body by contract with third parties. *Hudson County Water Co.* v. *McCarter*, 209 U.S. 349; *St. Louis Poster Adv. Co.* v. *St. Louis*, 249 U.S. 269. The Kansas Supreme Court was plainly correct in this case when it said:

> "We believe that the state may regulate the production of natural gas and the gathering of the same to the extent necessary to insure that the gas under one owner's land will not be drawn off by his neighbor, and that his neighbor cannot plead a contract with a third person to give him a right to drain gas from his neighbor."

The Commission has not argued and could not argue that the regulation here challenged would be invalid as applied to a purchaser who had not, as appellant has here, entered into private contractual arrangements with third parties. If the regulation would be valid in such circumstances it can hardly be less valid here.

In any event the force of the Commission's argument depends entirely on the assumption that the provisions of the contract between appellant and Republic are inviolable and cannot be affected by the state order. If this assumption is unsound then the Federal question that the Commission seeks to assert disappears, because appellant admittedly could comply with the Kansas order without affecting its total field purchases, by decreasing its take from the Republic "A" wells.

We submit that the Federal Power Commission's basic assumption is unsound. Under Kansas law, which is necessarily controlling, any prior contractual obligation between appellant and Republic is *pro tanto* modified by the Kansas regulation, and accordingly appellant is free to comply with the regulation by decreasing its take from Republic without violating the contract or incurring any liability thereunder.[2]

The Supreme Court of Kansas specifically noted that the contract between appellant and Republic is explicitly made subject to "all valid present and future orders, rules and regulations of duly constituted authorities having jurisdiction" (R. 158, No. 42,127). It was on this basis that the Supreme Court of Kansas held that the Kansas order raised no constitutional question with respect to the impairment of the con-

[2] See Northern Natural Gas Company v. Republic Natural Gas Company, 172 Kan. 450, 241 P. 2d 708.

tract (R. 158-159, No. 42,128). And indeed it is significant that appellant itself asserts that " * * * in event the challenged regulations should herein be determined to be valid, necessarily the contract obligations would have to yield thereto * * * ". (Appellant's Brief in Opposition to Motion to Dismiss, p. 10).

Even if this question of Kansas law could be said to be open or doubtful, there would still be no substantial Federal question now ripe for decision. On that assumption the antecedent question of state law upon which the asserted Federal question would depend would not have been authoritatively decided by the state court. In those circumstances the case should be remanded to the Supreme Court of Kansas for a definitive decision on the question of contract interpretation since the resolution of that question might well moot the Federal question which the Commission asserts is raised in this case. Compare *Leiter Minerals, Inc.* v. *United States*, 352 U.S. 220, 228-229.

2. In an attempt to support its contention that the order is not designed to protect correlative rights, the Commission attacks the order on the ground that it is not applicable as between different pipeline purchasers and accordingly does not provide for complete and absolute proportionate removal of gas from wells in the Kansas-Hugoton field. (Memorandum, pp. 2-3)

But the Commission cannot raise a Federal question by attacking the Kansas order on the ground that it does not go far enough in dealing with the problem of correlative rights or that it fails to meet some absolute standard of effectiveness. The Commission's reliance on this irrelevant criticism is simply one facet of its attack upon the motive of Kansas in promulgating the

ratable taking order.[3] This attack upon motive is likewise irrelevant. Unless it is to be asserted that Kansas has no power in any circumstances to order ratable taking to protect correlative rights—a proposition that the Commission does not embrace—then the order admittedly operates upon subject matter that is within the regulatory power of the state. It is well settled that if a state regulatory agency exercises power that is otherwise within its competence the exercise cannot be attacked on grounds of motive or on the ground that it was in part designed to further purposes which, considered alone, the state has no constitutional power to effect. *Stephenson* v. *Binford*, 287 U.S. 251, 276; *Amy* v. *Watertown*, 130 U.S. 301, 319; *Soon Hing* v. *Crowley*, 113 U.S. 703.

The fact is, however, that if the Kansas order is considered in the context of the entire regulatory plan of which it is a part, and in terms of the particular situa-

[3] The Commission also attacks the motives of Kansas in determining market demand for the purposes of the Basic Proration Order. (Memorandum, pp. 4-9) This passage of the Commission's argument relies upon alleged facts, conclusions and state orders that are not found in the record certified to this Court by the Clerk of the Kansas Supreme Court. Such matters were not before the courts below but instead are involved in another set of cases now pending before the Kansas Supreme Court. Southwestern Kansas Royalty Owners Association v. State Corporation Commission, et al., Case No. 42038; Colorado Interstate Gas Co. v. State Corporation Commission, Case No. 42185; Northern Natural Gas Co., et al. v. State Corporation Commission, Case Nos. 42175, 42176, 42230. The primary issue in these latter cases, often referred to as the "market demand cases," is whether the Kansas Commission has the power to set the volumetric market demand for gas at levels higher than the actual pipeline withdrawals. The sole question in the instant case is whether the Natural Gas Act deprives the states of authority to protect correlative rights of owners of natural gas resources within their boundaries.

tion to which it was directed, it affirmatively appears that the Commission's criticisms are without substance. The ratable taking order must be considered in relation to the Basic Proration Order issued for the Kansas-Hugoton field in 1944.[4] The primary purpose of the Basic Proration Order was to assure, within reasonable production limits, the ratable production of gas from all wells in the field. To effect this purpose the State Commission determined for each well an allowable based on geological and engineering data, and reflecting the comparative deliverability of each well with all other wells in the field.[5] Appellant defeated the purpose of the Basic Proration Order—the prevention of drainage and protection of correlative rights—by a gross failure to take ratably from its various connections. (The grossness of this failure is indicated in the Motion to Dismiss (see p. 6, n. 3)). Kansas was entitled to exercise its power to deal with this particular situation, and the fact that it did so without attempting to deal with less serious cases of injury to correlative rights does not invalidate the exercise of power or raise any Federal question. As this Court said in *Williamson* v. *Lee Optical Co.*, 348 U.S. 483, 489:

> "Evils in the same field may be of different dimensions and proportions, requiring different remedies. Or so the legislature may think. * * * Or the reform may take one step at a time, addressing itself to the phase of the problem which seems most

[4] The Basic Proration Order for the Hugoton Gas Field may be found on pages 7-29 of the Record in Case No. 42,127 and pages 6-28 of the Record in Case No. 42,128.

[5] "Deliverability" is a measure of and reflects the reserves underlying each well.

> acute to the legislative mind. * * * The legislature may select one phase of one field and apply a remedy there, neglecting the others. * * * [Citations omitted]

3. We have shown above that there is no merit in the Federal Power Commission's assertion that the Kansas regulation exerts a "leverage" upon interstate pipelines to purchase gas from one state rather than another.[6] But even if it is assumed *arguendo* that the regulation has this consequence, the regulation is still valid and the attack upon it raises no substantial Federal question.

The Commission's memorandum assumes that if an exercise of state regulatory power exerts "leverage" upon interstate pipelines to purchase natural gas from one state rather than another, the regulation enters into a field occupied by the Natural Gas Act and is invalid under the Supremacy Clause.

This argument misconceives and misapplies the criteria laid down by this Court for determining the validity of state action under the Natural Gas Act. Whether an exercise of state power invades the field occupied by the Natural Gas Act depends upon whether the power is one that the state could have constitutionally exercised prior to the passage of the Natural Gas Act. (See *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, 684, 685-687, and the other authorities cited

---

[6] As a consequence another of the arguments of the Commission is without merit. The Commission contends that the leverage exerted upon interstate pipelines will result in increased fuel costs to the ultimate consumer. Of course, if as indicated in the text, no such leverage is exerted by the Kansas order, no increased cost to the consumer can result.

at page 11 of the Motion to Dismiss.) The power exercised here by Kansas satisfies this test, because the power to require ratable taking is a state power that this Court had upheld prior to the passage of the Natural Gas Act. (See the authorities cited at page 12 of the Motion to Dismiss.)

It is significant that the Commission cites no provisions of the Natural Gas Act and no decisions of this Court in support of the proposition that if state action causes interstate pipelines to purchase natural gas from one state rather than another, the action conflicts with the regulatory authority of the Commission. In fact the Commission has no authority under the Natural Gas Act to apportion purchases of natural gas among states or to take any other action designed to control or influence the purchase of natural gas in one state rather than another. There is therefore no basis on which it can be argued that the action of the Kansas Commission has interfered with or is in conflict with any regulatory authority conferred upon the Federal Power Commission by the Natural Gas Act even if the action is assumed *arguendo* to exert "leverage" upon an interstate pipeline company. This Court has refused to strike down state regulatory action taken within the area reserved to the states under the Natural Gas Act in the absence of a clear showing that the exercise of the power is inconsistent with Federal authority. Compare *Panhandle Eastern Pipeline Co.* v. *Michigan Public Service Commission*, 341 U.S. 329, 334; *Panhandle Eastern Pipeline Co.* v. *Public Service Commission of Indiana*, 332 U.S. 507, 519-520, with *Cities Service Co.* v. *State Commission of Kansas*, 355 U.S. 391. No such showing is possible here because the Federal Power Commis-

sion has no authority to protect correlative rights by ordering ratable taking and no authority to adjust, to allocate or to distribute among the several producing states the volume of gas produced in those states for movement in interstate commerce.

4. The Commission attempts to avoid the legal significance of this Court's dismissal of the appeal in *Permian Basin Pipeline Company* v. *Railroad Commission of Texas*, 358 U.S. 37, by seeking to distinguish the facts and issues presented here from those involved in that case. The Memorandum urges that the *Permian* case is not apposite here because in that case (1) the total amount of gas flowing in interstate commerce was "not in issue", (2) the action taken by the Texas Railroad Commission could not have a direct impact upon the cost of gas to the pipeline company, and (3) the gas field was located within a single county in Texas.[1]

The first two suggested distinctions are wholly without merit because the Kansas ratable taking order does not affect "the total amount of gas flowing into interstate commerce" nor does it have any "impact upon the cost of gas to the pipeline company." As we have shown above, the Commission's argument to the contrary rests entirely upon its erroneous view of a question of Kansas law, *i.e.*, the effect of the Kansas order

[1] The memorandum also attempts to state a difference by alluding to the fact that in the Permian case, the gas was sold to a processing plant before being transported into interstate commerce. However, the Court found that the processing plant was merely part and parcel of the pipeline's gathering and transporting system, and it was to the pipeline company that the ratable take order was issued. The fact that a plant was interwoven into the transportation system is not a difference between that case and the instant one which has any legal significance.

on the contract between appellant and its favored supplier. Furthermore, as was noted in the Motion to Dismiss (p. 9), the appellant in the *Permian* case claimed, as the Commission here claims, that the pipeline company's contractual undertakings were such that the effect of the state order would necessarily be to require the pipeline either to purchase more gas for introduction into interstate commerce from the particular field or to pay damages for breach of contract. It is apparent that this Court did not regard this argument as raising a substantial Federal question.

The fact that the *Permian* case involved a gas field in one state, and that this case involves a gas field extending through three states, has no legal significance. In both cases, although the ratable taking orders were confined in their application to activities within the borders of a single state, they were directed to interstate pipeline companies which were engaged in moving gas in interstate commerce. In these circumstances the question whether the particular gas reserves were confined to one county or extended under the surface through more than one state cannot affect the validity of the orders under the Natural Gas Act.

CONCLUSION

For the foregoing reasons the appeal should be dismissed for lack of a substantial Federal question. In the alternative, if the Court should be of the view that this case may present a Federal question depending upon the resolution of an antecedent question of Kansas contract law, and should believe that that question has not already been resolved by the Kansas courts,

the case should be remanded to the Supreme Court of Kansas for resolution of that antecedent question.

Respectfully submitted,

JEROME ACKERMAN
Union Trust Building
Washington 5, D. C.

CHARLES C. MCCARTER
State Corporation Commission
State Office Building
Topeka, Kansas

Attorneys for Appellee

May 15, 1962